

DEVELOPMENT FUND FOR IRAQ

Report of Factual Findings

In Connection With

Oil Proceeds Receipts Account

For the year ended 31 December 2006



**Private and confidential**

29 March 2007

**To the Government of Iraq and International Advisory and Monitoring Board  
of the Development Fund for Iraq**

**REPORT OF FACTUAL FINDINGS - OIL PROCEEDS RECEIPTS ACCOUNT**

We have performed the procedures agreed with you and set out in Appendix A of the attached report with respect of Oil Proceeds Receipts Account (OPRA) of the Development Fund for Iraq. Our engagement was undertaken in accordance with International Standard on Related Services (ISRS) No. 4400, engagements to perform agreed-upon procedures regarding financial information. The procedures were performed solely to assist the Government of Iraq and the International Advisory and Monitoring Board (IAMB) in evaluating the Development Fund for Iraq's compliance with United Nations Security Council Resolution (UNSCR) 1483 paragraph 20 and 21, for the year ended 31 December 2006. The Government of Iraq is responsible for the Development Fund for Iraq's compliance with UNSCR 1483.

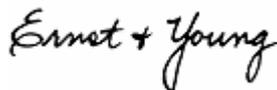
We report our findings in sections 1 to 3 in the attached report.

Because the procedures, which are detailed in Appendix A to this report, do not constitute an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance.

Had we performed additional procedures or had we performed an audit or review made in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for the information of the Government of Iraq and the IAMB and is not to be used for any other purpose or by any other parties. We do not accept or assume responsibility for any other purpose or to any other person who may receive this agreed upon procedures report. This report relates only to the accounts and items specified in Appendix A of the attached report, and does not extend to any financial statements of the Development Fund for Iraq taken as a whole.

Yours faithfully  
Ernst & Young



Baghdad, Iraq

**DEVELOPMENT FUND FOR IRAQ  
REPORT OF FACTUAL FINDINGS  
IN CONNECTION WITH OIL PROCEEDS RECEIPTS ACCOUNT**

**1. AGREE EXPORT SALES RECORDED BY SOMO TO DEPOSITS IN OPRA**

**1.1 PROCEDURE PERFORMED**

We obtained from the Federal Reserve Bank of New York (FRBNY) statements of transactions for the year ended 31 December 2006 and we agreed the amounts of export sales of petroleum as recorded by the Oil Marketing Company (SOMO), to the amounts deposited into the Oil Proceeds Receipts Account (OPRA) at the FRBNY.

**1.2 FINDINGS**

**PETROLEUM EXPORT SALES**

- We found that no export sales of natural gas took place in Iraq during the year ended 31 December 2006, due to the absence of infrastructure for the export of natural gas.
- We found that SOMO's policy for export sales of petroleum is to accept payments primarily through irrevocable documentary letters of credit (LCs), ensuring that full payment is received for all exports.
- We found that the total export sales and barter transactions of petroleum and petroleum products for the year ended 31 December 2006 were as follows:

	U.S. \$		
	Export Sales	Barter	Total
Petroleum	30,397,043,684	168,230,355	30,565,274,039
Petroleum Products	647,651,302	7,307,126	654,958,428
<b>Total</b>	<b>31,044,694,986</b>	<b>175,537,481</b>	<b>31,220,232,467</b>

- We reconciled the list of export sales of petroleum as stated in SOMO's records to the amounts deposited into OPRA at the FRBNY as follows:-

	<u>Note</u>	<u>U.S. \$</u>
Total export sales of petroleum per SOMO's records		30,397,043,684
<b>Add:</b>		
December 2005 export sales collected during January 2006	I	1,499,735,920
Interest on delayed payments	II	369,611
<b>Less:</b>		
December 2006 export sales collected during January 2007	I	(2,068,606,201)
Deducted demurrage from invoices	III	(16,017,454)
Seized amount by Court of Roma	IV	(10,886,400)
<b>Deposits in OPRA per CBI's records</b>		<b>29,801,639,160</b>
Deposit in OPRA not included in SOMO's records	V	5,000,000
<b>Deposits in OPRA per FRBNY confirmation</b>		<b>29,806,639,160</b>

**DEVELOPMENT FUND FOR IRAQ  
REPORT OF FACTUAL FINDINGS  
IN CONNECTION WITH THE OIL PROCEEDS RECEIPTS ACCOUNT**

---

- I. We found that proceeds from export sales of petroleum for the year ended 31 December 2006 were deposited into OPRA approximately 30 days after the lifting, in accordance with the terms of letters of credit. Therefore, there is an amount of U.S. \$ 1,499,735,920 related to December 2005 export sales deposited into OPRA during January 2006. Also, there is an amount of U.S. \$ 2,068,606,201 related to December 2006 export sales of petroleum deposited into OPRA during January 2007.
  - II. This amount represents received interest for delayed bank transfers.
  - III. This amount represents deducted demurrage from export sales invoices as a result of detention of the buyers' vessels in port beyond the number of days allowed for the purpose of loading as per contractual terms.
  - IV. This amount was seized based on Court of Roma – Italy seizure order on 23 March 2006 as a result of a lawsuit against the Iraqi Ministry of Planning. The Government of Iraq is following up the collection of this amount and believes that the court order violates UNSCR 1483.
  - V. This amount is recorded in the OPRA statement of accounts at the FRBNY, while it does not appear on SOMO's records. The amount was erroneously deposited on 10 October 2006 in the OPRA instead of the CBI account at the FRBNY. Later during 2007, the amount was refunded to the CBI account at the FRBNY.
- We further found that SOMO does not properly prepare and document the reconciliation of its records of export sales of petroleum with CBI's oil proceeds statement of account on a monthly basis.

**PETROLEUM PRODUCTS EXPORT SALES**

- We found that SOMO's policy for export sales of petroleum products is to sell primarily through cash advance payments, except for a limited number of sales through letters of credit and barter transactions.
- We found that cash advances received for, and proceeds of, export sales of petroleum products during the year ended 31 December 2006 amounted to U.S. \$ 638,192,881 as recorded in SOMO's accounting records.
- The export sales of petroleum products, excluding barter transactions, during the year ended 31 December 2006 were as follows:

	U.S. \$
Export sales of petroleum products	647,651,302
Total proceeds deposited into SOMO's banks accounts	638,192,881
Difference	9,458,421

- As shown in the above table there is un-reconciled difference of U.S. \$ 9,458,421 between the total sales and total collections during the year. We did not receive a reconciliation or analysis of this difference.
- We found that the net cash advances of U.S. \$ 638,192,881 were not deposited into OPRA in accordance with UNSCR 1483, with the funds being deposited into SOMO bank accounts at the Trade Bank of Iraq and Al-Rafidain Bank's Baghdad and Amman branches.

**DEVELOPMENT FUND FOR IRAQ  
REPORT OF FACTUAL FINDINGS  
IN CONNECTION WITH THE OIL PROCEEDS RECEIPTS ACCOUNT**

---

- We found that SOMO does not properly prepare and document the reconciliation of its records of export sales of petroleum products with its bank accounts on a monthly basis.
- We found that SOMO does not properly prepare and document monthly reconciliations for its banks accounts. The reconciliations have been prepared at year-end, except for the account at Al-Rafidian Bank Amman Branch.
- We found that there are significant old and recent pending reconciling items in SOMO's bank reconciliations. The total reconciling items in the debit side amounted to U.S. \$ 2,942,065,802 and in the credit side amounted to U.S. \$ 1,626,209,450 as of 31 December 2006.
- We found that the Iraqi Ministry of Electricity engaged in barter transactions with KARTET KARADENIZ TOPTAN ELEKTRIC COMPANY (the "Turkish company") for exporting of petroleum products in exchange for electricity. According to the signed agreement dated 14 January 2004, between SOMO and the Turkish company, SOMO will charge U.S. \$ 27 per ton of export sales to the Turkish company and the remaining balance (the difference between the U.S. \$ 27 and the Official Selling Price) shall be charged to the Iraqi Ministry of Electricity.
- The following is a summary of the export sales of petroleum products to the Turkish company for the year ended 31 December 2006 according to SOMO's records, which are not reconciled with the Turkish company:

	<u>U.S. \$</u>
Charges to the Turkish company (fully paid during 2006)	5,350,741
Charges to the Iraqi Ministry of Electricity	<u>34,397,236</u>
Total export sales of petroleum products	<u><u>39,747,977</u></u>

- We found that the total amount due from the Iraqi Ministry of Electricity to SOMO as of 31 December 2006, as consequence to the barter agreement with the Turkish company is U.S. \$ 34,397,236. The Ministry of Electricity did not pay the amount due to SOMO. Also, there is no confirmation or statement from the Ministry of Electricity.
- From SOMO point of view, the arrangement with the Turkish company is not considered barter transactions as SOMO receives part of the value of the sales from the Turkish company and the remaining is charged to the Iraqi Ministry of Electricity.

#### **BARTER TRANSACTIONS**

- We found that on 5 January 2006 SOMO renewed the barter agreement with the Syrian Government for the exports of petroleum and petroleum products. Barter transactions were mainly in the form of exporting petroleum in exchange for electricity and petroleum products, and exporting fuel oil in exchange for petroleum products.

**DEVELOPMENT FUND FOR IRAQ  
REPORT OF FACTUAL FINDINGS  
IN CONNECTION WITH THE OIL PROCEEDS RECEIPTS ACCOUNT**

- We found that, as barter transactions are non-cash transactions, no cash was deposited into OPRA or the Development Fund for Iraq (DFI) account and Compensation Fund.
- We found that the total amount of bartered petroleum and petroleum products with the Syrian Government was U.S. \$ 168,230,355 and U.S. \$ 7,307,126 respectively, for the year ended 31 December 2006.
- Following is a summary of the monthly barter transactions for the year ended 31 December 2006, according to SOMO's records:

	U.S. \$		
	Petroleum	Petroleum Products	Total
January	-	-	-
February	-	1,244,393	1,244,393
March	-	128,291	128,291
April	8,490,419	173,740	8,664,159
May	20,716,477	-	20,716,477
June	21,838,195	-	21,838,195
July	25,397,342	-	25,397,342
August	23,921,676	1,206,880	25,128,556
September	16,082,253	3,875,426	19,957,679
October	17,278,656	678,396	17,957,052
November	17,512,528	-	17,512,528
December	16,992,809	-	16,992,809
	<b>168,230,355</b>	<b>7,307,126</b>	<b>175,537,481</b>

- We found that the amount due from the Syrian Government per SOMO's records as of 31 December 2006 is U.S. \$ 92,324,823. This amount is neither confirmed by, nor reconciled, with the Syrian Government.
- According to the signed agreement between SOMO and the Syrian Government, the two parties should meet on a monthly basis to settle the outstanding amount due to each party. However, such meetings were not held on a monthly basis and no final reconciliation has been prepared for 2006.
- Also according to the signed agreement, when the amount due exceeds U.S. \$ 10 million for more than three months, a cash payment covering 75% of the due amount should be transferred to the other party. However, during the period, the amount due from the Syrian Government exceeded U.S. \$ 10 million for more than three months and no cash transfer was made during 2006.

**DEVELOPMENT FUND FOR IRAQ  
REPORT OF FACTUAL FINDINGS  
IN CONNECTION WITH THE OIL PROCEEDS RECEIPTS ACCOUNT**

**2. TRANSFERS FROM OPRA TO DFI ACCOUNT AND COMPENSATION FUND**

**2.1 PROCEDURES PERFORMED**

- We recalculated the amounts transferred from OPRA, pursuant to the allocation requirements of UNSCR 1483 paragraphs 20 and 21.
- We agreed the calculation for the transferred amount with the actual transferred amounts to the DFI account and the Compensation Fund.

**2.2 FINDINGS**

- We found that the proceeds of each petroleum export sales transaction was deposited into OPRA and, immediately thereafter, 95% was deposited into the DFI account at the FRBNY, with the remaining 5% being deposited into the Compensation Fund in accordance with UNSCR 1483. The DFI account at the FRBNY is managed by the Central Bank of Iraq (CBI) on behalf of the Ministry of Finance. The Compensation Fund was established in accordance with UNSCR 687 and subsequent relevant resolutions, as a result of the Iraqi invasion of Kuwait during 1990.
- The following are the proceeds resulting from export sales of petroleum that were deposited into OPRA during the year ended 31 December 2006:

Period of Export	U.S. \$		
	OPRA	DFI	Compensation Fund
Proceeds from 2006 Export Sales	28,307,287,605	26,891,923,225	1,415,364,380
Proceeds from 2005 Export Sales *	1,499,351,555	1,424,383,977	74,967,578
<b>Total per FRBNY</b>	<b>29,806,639,160</b>	<b>28,316,307,202</b>	<b>1,490,331,958</b>
<b>Total per CBI</b>	<b>29,801,639,160</b>	<b>28,311,557,202</b>	<b>1,490,081,958</b>
<b>Difference</b>	<b>5,000,000</b>	<b>4,750,000</b>	<b>250,000</b>

- \* U.S. \$ 1,499,351,555 represents proceeds of December 2005 export sales of petroleum, which were deposited into OPRA during January 2006, the amount is net of deducted demurrage of U.S.\$ 384,365.
- We recalculated the amounts transferred from OPRA to the DFI account and the Compensation Fund pursuant to the allocation requirements of UNSCR 1438 paragraph 20 and 21 for the year ended 31 December 2006 to be as follows:

	U.S. \$
Transferred to DFI account (95%)	28,316,307,202
Transferred to the Compensation Fund (5%)	1,490,331,958
<b>Total deposits in OPRA per FRBNY confirmation</b>	<b>29,806,639,160</b>

**DEVELOPMENT FUND FOR IRAQ  
REPORT OF FACTUAL FINDINGS  
IN CONNECTION WITH THE OIL PROCEEDS RECEIPTS ACCOUNT**

---

- We found a difference in the amount of U.S. \$ 4,750,000 between the recalculated amount that should be transferred from OPRA to the DFI and the actual transferred amount.
- In addition, we found a difference amounting to U.S. \$ 250,000 between the recalculated amount that should be transferred to the Compensation Fund and the actual transferred amount. United Nations confirmation clarified the difference as an erroneous transfer that has been refunded to the FRBNY later in 2007.
- We found that the above differences were resulted from erroneous deposit of U.S. \$ 5,000,000 in the OPRA on 10 October 2006 instead of the CBI account at the FRBNY. As a result, 95% of this amount was transferred form the OPRA to the DFI account at the FRBNY and the remaining 5% was transferred to the Compensation Fund. Later during 2007, the amount was refunded to the CBI account at the FRBNY.

3. TRANSFERS TO COMPENSATION FUND

3.1 PROCEDURES PERFORMED

- We obtained confirmation from the United Nations regarding the amounts transferred from OPRA to the Compensation Fund during year ended 31 December 2006.
- We compared the amount transferred from OPRA to the Compensation Fund as stated in the FRBNY statement of transactions with the confirmation received from the United Nations.

3.2 FINDINGS

- We compared the total amount transferred from OPRA to the Compensation Fund with the confirmation received from the United Nations and found no difference, as follows:

	U.S. \$
Total transfers per FRBNY statement of transactions	1,490,331,958
Total amount deposited into the Compensation Fund according to United Nations confirmation	1,490,331,958
<b>Difference</b>	<b>-</b>

- As mentioned in finding 2.2, the amount transferred to the Compensation Fund includes U.S. \$ 250,000 that was erroneously transferred to the Compensation Fund during 2006. Later in 2007, the amount was refunded to the FRBNY.

**SCOPE OF WORK**

In accordance with the agreed upon scope of work set out in our engagement letter dated 12 August 2006, the procedures to be performed in connection with Oil proceeds Receipt Account (OPRA) held on behalf of the Central Bank of Iraq at the Federal Reserve Bank of New York (FRBNY) are as follows:

1. Obtain from the FRBNY statements of transactions for the year ended 31 December 2006; agree the amounts of export sales of petroleum, petroleum products and natural gas, as recorded by the Iraqi Oil Marketing Company, to the amounts deposited into OPRA.
2. Recalculate the amounts to be transferred from OPRA, pursuant to the allocation requirements of UNSCR 1483 paragraphs 20 and 21, and agree these payments to the cash deposited into the Development Fund for Iraq (DFI) account and to the cash transferred to the Compensation Fund.
3. Obtain a confirmation from the United Nations regarding the amounts transferred from OPRA to the Compensation Fund during the year ended 31 December 2006.